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Utah Supreme Court

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Romney and Boyer; Attorneys for Appellants;

Recommended Citation

Brief of Appellant, *Seaboard Finance Co. v. Shire*, No. 7299 (Utah Supreme Court, 1949).
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IN THE SUPREME COURT
OF THE STATE OF UTAH

FILED

SEABOARD FINANCE COMPANY,
a corporation,

Plaintiff and Appellant,

vs.

L. V. SHIRE, doing business as Shire
Motor Company,

Defendant,

BANK OF VERNAL, VERNAL,
UTAH, a corporation,
Garnishee and Respondent.

MAR 28 1940

CLERK, SUPREME COURT, UTAH

Case No.
7299

Appellant's Brief

ROMNEY AND BOYER,
Attorneys for Appellants.

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7299

Appellant's Brief

STATEMENT OF FACTS

This action involves a dispute between the Plaintiff and the Garnishee Defendant, Bank of Vernal, hereinafter called "The Bank." The appeal is on the judgment roll only. A detailed statement of facts is contained in the Findings of Fact, Tr. No. 74-84.

Briefly the essential facts are:

Prior to the time of garnishment in this action the Defendant, L. V. Shire, became indebted to the Bank

on three promissory notes, one for \$11,270.00, one for \$2,065.00 and one for \$1,500.00. The \$11,270.00 note was secured by a Trust Receipt and a Chattel Mortgage on five Frazer automobiles. The note for \$2,065.00 was unsecured and the note for \$1,500.00 was secured by a Chattel Mortgage on automotive equipment.

In the month of February, 1948, the Defendant, Shire, had a checking account in the Bank. On February 17, 1949 without any authority from the Defendant, Shire, the Bank charged Shire's bank account with the sum of \$2,783.17, and applied the same in reduction of the balance owing on the \$11,270.00 note which was then owing by Shire to the Bank. On February 21, 1948, without any authority from the Defendant, Shire, the Bank charged Shire's account with the sum of \$2,605.00 and applied \$1,800.00 of said sum on the \$2,065.00 note and applied \$805.00 of said sum on the \$1,500.00 note.

A Garnishment was served on the Bank on February 24, 1948, but the charging of Shire's account as aforesaid depleted his funds in said account in said Bank.

At the time of the service of the Garnishment the Court found that the Bank had in its possession a 1947 Frazer automobile which was one of the automobiles included in the Trust Receipt and Chattel Mortgage referred to above, some accessories and miscellaneous automotive equipment and a used Ford sedan.

After the service of the Writ of Garnishment the Bank sold the Ford automobile and applied the net pro-

ceeds in payment of the balance owing on the \$2,065.00 note. Thereafter the mortgage securing the \$1,500.00 note was foreclosed. The mortgage securing the \$11,270.00 note was never foreclosed. The interest of the Defendant, Shire, in the Frazer automobile was attached by the Plaintiff in this action and the Plaintiff and the Bank joined in the sale thereof for \$1,925.00, which funds were retained by the Bank.

The Court found that after the amounts realized from the sale of the two automobiles and mortgaged property that there was a balance of \$163.58 in possession of the Bank subject to Garnishment.

STATEMENT OF ERRORS

The Trial Court erred in the following :

1. In concluding that the Bank had the right to retain the credits of the Defendant, Shire, in his checking account and apply the same in payment of the balance of his indebtedness to said Bank which remained after applying thereon the proceeds of the sale of the two automobiles and the remaining mortgaged chattels.

2. In concluding that the sum of \$163.58 only was subject to the Garnishment of the Plaintiff.

3. In failing to conclude that the amounts which were charged against the Defendant, Shire's account and applied on the two secured notes were subject to the Plaintiff's Writ of Garnishment.

4. In entering a Garinshee Judgment against the Bank for the sum of 163.58 only.

5. In failing to make and enter a Garnishee Judgment against said Bank for the amounts which were charged against the bank account of the Defendant, Shire, and applied on the two secured notes of Shire which were held by the Bank.

ARGUMENT

All of the Assignments of Error have to do with one question, namely: when served with the Writ of Garnishment did the Bank have the right to retain the credits of the Defendant, Shire, in its possession until it had exhausted its security and apply said credits on the deficiency owing by the Defendant, Shire, if any?

This involves a construction of Section 104-19-13 of the Utah Code Annotated, 1943, which reads as follows:

“Every garnishee shall be allowed to retain or deduct out of the property, effects or credits of the defendant in his hands all demands against the plaintiff *and all demands against the defendant of which he could have availed himself if he had not been summoned as garnishee, whether the same are at the time due or not*, and he shall be liable for the balance only after all *mutual demands* between himself and plaintiff and defendant are adjusted, not including unliquidated damages for wrongs and injuries; provided, that the verdict or finding, as well as the record of the judgment, shall show in all cases against which party any counter claim is allowed, if any is allowed, and the amount thereof.” (Italics ours)

The key to the meaning of the statute is found in the italicized portions above. To paraphrase the wording of the statute, the Bank had the right to retain or deduct out of the property subject to Garnishment all of the demands against the defendant *of which it could have availed itself if it had not been summoned as Garnishee whether the same were at the time due or not*, and was liable to the Plaintiff after all *mutual demands* between itself and the Defendant, Shire, were adjusted.

Plaintiff contends the case of Zion's Savings Bank and Trust Company, vs., Rouse 86 Utah 574, 47 Pac. 2d 618, is conclusive authority for the proposition that the secured notes of Shire held by the Bank were not "demands" which the Bank could have availed itself of "had it not been summoned as Garnishee," and that the checking account and the secured notes were not such "mutual demands" which might be adjusted as contemplated by the statute. In the Rouse case, the Defendants therein had obtained three loans from the Bank, one in 1925, which was secured by a real estate mortgage, one in 1932, secured by a Chattel Mortgage, and one in 1933 secured by a Chattel Mortgage. The proceeds of the 1933 loan were left with the Bank and without authority from the Defendants applied by the Bank in payment of the 1925 loan which was then past due. The Bank then brought an action to foreclose the two Chattel Mortgages securing the notes of 1932 and 1933. The Defendants pleaded a Counter Claim to the Second Cause of Action, that of the note of 1933, for the sum of \$857.00, which was the amount of the proceeds of the 1933 loan and which pro-

ceeds had been taken by the Bank and applied on the 1925 note which was secured by a real estate mortgage.

The Court construed Section 104-55-1 of the Utah Code Annotated, 1943, which reads in part as follows:

“There can be but one action for the recovery of any debt or the enforcement of any right secured by mortgage upon real estate or personal property, which action must be in accordance with the provisions of this chapter . . .”

The Court referred to an earlier Utah case of Blue Creek Land & Livestock Co., vs. Kehrer, 60 Utah 62, 206 Pac. 287, which case held that a mortgagee can not levy a Garnishment or Attachment on property of the debtor in the hands of a third person without first exhausting its security and obtaining a deficiency judgment. The Court then held in the instant case that the Bank had no rights of off-set permitting it to apply the funds in its possession on the secured note of 1925 before a deficiency judgment was obtained. In discussing this proposition the Court said on page 619:

“From these decisions it would seem to follow logically and naturally that a mortgagee, who could not reach by attachment or garnishment the assets of the debtor in the hands of a third party, could not for similar reasons apply personal credits in its own hands as an offset in reduction of the mortgage debt.

“(3) The right of a bank to apply a depositor's funds, held by it, to payment of his indebtedness, can exist only where each occupies the position of debtor and creditor, and where there exists mutual demands. 5 Michie, Banks and

Banking 216. Both maturity and mutuality are essential to the validity of a setoff.

“(4) The status of the mortgage debt under a statute like R. S. Utah 1933, 104-55-1, construed as it has been by this court, is somewhat analogous to one not yet due, or one that lacks mutuality. True the debt is past due but the creditor is not yet in a position to obtain personal judgment against the debtor or to proceed to satisfy the debt out of the debtor's assets other than the mortgaged property. *Until the fund set up as a security for the debt is exhausted and the deficiency, if any, is ascertained, the debts are on a different footing. They are not mutual personal obligations which may be set off against each other and compensated pro tanto.*” (Italics ours)

The reason for the rule is stated by the Court on Page 620 in a quotation from 4. Cal. Jur. 270:

“The reason of the rule which gives to banks the right to appropriate deposits for the payment of the debtor's matured indebtedness does not apply where the bank has security for that indebtedness. The ordinary presumption that it is the depositor's intent to have his note discharged from his deposit does not exist where the note is so secured. It has been said to be but reasonable that when the legislature declared that there should be but one action to enforce a debt secured by mortgage, it did not mean that payment could be enforced against the consent of the mortgagor by giving a bank the right to enforce payment under a general banker's lien upon some other property, and that, to, without any legal proceedings whatever. The rule, therefore, is that a mortgagee bank must first look to the mortgaged premises as constituting a primary fund out of which the debt secured by the mortgage must be paid, and

that mortgage security must be exhausted before it can apply in reduction or cancellation of the debt any money on deposit with it belonging to the debtor."

When the Bank of Vernal charged the Defendant, Shire's, account as it did, and applied the funds in payment of his secured indebtedness, Shire would have had a right to recover such funds from the Bank as did the Defendants in the Rouse case, *supra*.

The Rouse case is conclusive authority for the proposition that as between the Defendant, Shire, and the Bank, the Bank had no right of setoff. What greater right of setoff, if any, did the Bank acquire through Garnishment?

Broken down in its essential parts, the statute in question permits the Garnishee to retain or deduct out of the property garnisheed all demands of the Plaintiff and all demands against the Defendant:

1. Of which the Garnishee could have availed himself if he had not been summoned as Garnishee.
2. Whether the same are due or not.
3. And shall be liable only after all mutual demands between himself and plaintiff and defendant are adjusted.

There are no demands claimed between Plaintiff and the Garnishee so this element may be eliminated. From the previous discussion of the Rouse case, *supra*, it is obvious that the Bank could not have availed itself of its secured demands, if it had not been summoned as Garnishee, which disposes of item (1), and likewise the

Rouse case holds that the secured indebtedness held by the Bank against the Defendant, Shire, and his checking account in said Bank were not mutual demands which could be adjusted between the Defendant and the Bank, which disposes of item (3) above. The only enlargement of the right of setoff created by the statute is found in item (2) in that it includes demands not yet due. This undoubtedly means that if the Bank had an unsecured demand against the Defendant which was not due at the time of the Garnishment it could nevertheless offset the same against the funds garnisheed. However, in referring to demands not yet due the statute can not be said to include secured obligations because there is no demand, as such, in existence prior to the time the security is exhausted and a deficiency judgment is obtained. In the case of the secured obligation there is only a prospective possibility of a demand which may or may not arise the future, depending on whether the security is sufficient to satisfy the obligation.

To contend that part number (2) of the statute as set forth above includes a secured obligation prior to deficiency judgment is to confuse an unmatured existing demand with the question of whether or not a demand exists at all. We have no doubt but what the Legislature intended to include a demand which was then in existence but not yet due rather than the prospective possibility of a demand which might never come into existence. Therefore the enlargement of the right of setoff granted by the statute does not include the secured obligations owing by the Defendant, Shire, to the Bank.

There is no hardship or inequity in such an interpretation as stated in Zollman in his work on Banks and Banking, Paragraph 4542, which reads as follows:

“The taking of collateral security for a note is inconsistent with the theory upon which a setoff, or banker’s lien is founded. The bank by accepting the note relies not on the general balance of the maker, but on the security which he offers.”

The question before this Court was involved in the case of Walters, vs., Bank of America, National Trust and Savings Association which went before the Supreme Court of California upon four occasions, and opinions are reported in 44 Pac. 2d 601, 52 Pac. 2d 232, 59 Pac. 2d 983 and 69 Pac. 2d 839.

In the Walters case the Plaintiff contended the bank had no right to setoff a secured indebtedness against the garnisheed funds and urged the same argument advanced by the Appellant herein. The Plaintiff in the Walters case cited Section 726 of the Civil Code of Procedure of California, which is the same in substance as Section 104-51-1 of the Utah Code Annotated, 1943, and cited cases construing said section which upheld the same rule as that advanced by this Court in the Rouse case, supra. The bank in the Walters case, however, urged that the rule of the cases cited had been altered by the amendment of Section 438 of the Civil Practice Act which provides that the right to maintain a counter claim shall not be effected by the fact that either the Plaintiff’s or the Defendant’s claim is secured by mortgage, or otherwise.

Some of the Headnotes indicated that the Court decided that the bank was entitled to a setoff although the obligation was secured. However, an examination of the case shows that the Court did not so hold, but held that the Plaintiff had waived its right of setoff. The Court did not make any decision as to what the effect of Section 438 was with respect to the rule of the cases cited. The Walters case is important not for what the Court held, but because of what the Court did not hold. In other words, aside from the possible affect of Section 438, which provision is not contained in the Utah Law, the doctrine of the cases standing for the same proposition as the Rouse case, *supra*, was held to be applicable to a case of garnishment and was not disturbed.

In our search of the authorities we have found no case in which a setoff of a secured indebtedness against garnisheed funds was allowed in states which follow the rule that there shall be but one action for the recovery of a secured indebtedness.

The Appellant therefore respectfully urges this Court to set aside the Conclusions of Law and Judgment of the trial Court and to make Conclusions of Law and Judgment in favor of the Plaintiff and against the Bank of Vernal for the amounts charged by the Bank against the Defendant Shire's, account and applied upon its secured indebtedness.

Respectfully submitted,

ROMNEY AND BOYER,
Attorneys for Appellants.